KINGSWAY FINANCIAL SERVICES INC
Form 10-Q
May 14, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

March 31, 2012
or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2012

Commission File Number: 001-15204

Kingsway Financial Services Inc.
(Exact name of registrant as specified in its charter)

Ontario, Canada (State or other jurisdiction of incorporation or organization)	Not Applicable (I.R.S. Employer Identification No.)

45 St. Clair Avenue West, Suite 400 Toronto, Ontario M4V 1K9
(Address of principal executive offices and zip code)
1-416-848-1171
(Registrant's telephone number, including area code)

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller Reporting Company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x

The number of shares outstanding of the registrant's common stock as of May 14, 2012 was 52,595,828.

KINGSWAY FINANCIAL SERVICES INC.

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KINGSWAY FINANCIAL SERVICES INC.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
Consolidated Balance Sheets
(in thousands, except per share data)

	March 31, 2012 (unaudited)	December 31, 2011
ASSETS		
Investments:		
Fixed maturities, at fair value (amortized cost of $103,107 and $91,344, respectively)	$105,032	$93,651
Equity investments, at fair value (cost of $2,689 and $2,689, respectively)	3,264	2,960
Other investments, at cost which approximates fair value	488	488
Short-term investments, at cost which approximates fair value	3,335	20,334
Total investments	112,119	117,433
Investment in investees	46,730	48,689
Cash and cash equivalents	72,646	85,486
Accrued investment income	1,921	1,999
Premiums receivable, net of allowance for doubtful accounts of $3,671 and 3,653, respectively	40,016	28,732
Service fee receivable	14,569	12,947
Other receivables, net of allowance for doubtful accounts of $806 and $806, respectively	5,883	6,322
Reinsurance recoverable	1,293	697
Prepaid reinsurance premiums	3,650	2,024
Deferred policy acquisition costs, net	8,403	8,116
Income taxes recoverable	7,416	8,134
Property and equipment, net of accumulated depreciation of $28,268 and $27,736	12,856	13,040
Goodwill and intangible assets	39,631	39,631
Other assets	372	831
TOTAL ASSETS	$367,505	$374,081
LIABILITIES AND EQUITY		
LIABILITIES		
Unpaid loss and loss adjustment expenses	$106,057	$120,258
Unearned premiums	45,641	39,423
Reinsurance payable	2,443	1,913
LROC preferred units	10,789	8,845
Senior unsecured debentures	27,982	28,337
Subordinated debt	19,174	16,432
Deferred income tax liability	2,653	2,653
Notes payable	2,418	2,418
Deferred revenue	12,331	11,128
Accrued expenses and other liabilities	32,275	26,269
TOTAL LIABILITIES	261,763	257,676
EQUITY		
Common stock, no par value; unlimited number authorized; 52,595,828 and 52,345,828 issued and outstanding at March 31, 2012 and December 31, 2011,	$296,621	$296,489

respectively		
Additional paid-in capital	15,372	15,403
Accumulated deficit	(212,214)	(201,208)
Accumulated other comprehensive income	14,588	12,749
Shareholders' equity attributable to common shareholders	114,367	123,433
Noncontrolling interests in consolidated subsidiaries	(8,625)	(7,028)
TOTAL EQUITY	105,742	116,405
TOTAL LIABILITIES AND EQUITY	$367,505	$374,081

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Statements of Operations
(in thousands, except per share data)
(Unaudited)

	Three months ended March 31, 2012	2011
Revenue:		
Net premiums earned	$29,267	$45,636
Service fee and commission income	9,529	8,972
Net investment income	830	1,077
Net realized gains	273	1
Loss on change in fair value of debt	(4,331)	(2,605)
Other income	1,083	1,911
Total revenues	36,651	54,992
Expenses:		
Loss and loss adjustment expenses	21,775	41,577
Commissions and premiums taxes	4,419	7,378
General and administrative expenses	18,801	21,571
Interest expense	1,849	1,903
Amortization of other intangible assets	—	18
Total expenses	46,844	72,447
Loss before equity in net loss of investees and income tax expense (benefit)	(10,193)	(17,455)
Equity in net loss of investees	(2,270)	—
Loss from continuing operations before income tax expense (benefit)	(12,463)	(17,455)
Income tax expense (benefit)	59	(408)
Loss from continuing operations	(12,522)	(17,047)
Loss on disposal of discontinued operations, net of taxes	—	(1,293)
Net loss	(12,522)	(18,340)
Less: net loss attributable to noncontrolling interests in consolidated subsidiaries	(1,514)	(534)
Net loss attributable to common shareholders	$(11,008)	$(17,806)
Loss per share - continuing operations:		
Basic and diluted:	$(0.24)	$(0.33)
Loss per share – net loss:		
Basic and diluted:	$(0.24)	$(0.35)
Weighted average shares outstanding (in ‘000s):		
Basic and diluted:	52,406	52,156

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Statements of Comprehensive Loss
(in thousands)
(unaudited)

	Three months ended March 31, 2012	2011
Net loss	$(12,522)	$(18,340)
Other comprehensive income, net of taxes[1]:		
Unrealized gains (losses) on fixed maturities and equity investments:		
Unrealized gains (losses) arising during the period	(220)	83
Reclassification adjustment for losses (gains) included in net loss	142	(31)
Foreign currency translation adjustments	1,524	2,560
Equity in other comprehensive income of investees	311	—
Loss on cash flow hedge	—	(200)
Other comprehensive income	1,757	2,412
Comprehensive loss	(10,765)	(15,928)
Less: comprehensive loss attributable to noncontrolling interests in consolidated subsidiaries	(1,596)	(480)
Comprehensive loss attributable to common shareholders	$(9,169)	$(15,448)

(1) Net of income tax expense (benefit) of $0 for the three months ended March 31, 2012 and March 31, 2011.
See accompanying notes to unaudited consolidated financial statements

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Three months ended March 31, 2012	2011
Cash provided by (used in):		
Operating activities:		
Net loss	$(12,522)	$(18,340)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss from discontinued operations and disposal of discontinued operations	—	1,293
Equity in net loss of investees	2,270	—
Depreciation and amortization	532	691
Stock based compensation expense, net of forfeitures	(31)	(243)
Net realized gains	(273)	(1)
Loss on change in fair value of debt	4,331	2,605
Deferred income taxes	—	7
Amortization of fixed maturities premiums and discounts	650	181
Changes in operating assets and liabilities:		
Premiums and service fee receivable	(12,906)	2,747
Reinsurance recoverable	(596)	7,707
Deferred policy acquisition costs	(287)	884
Income taxes recoverable	718	1,150
Funds held in escrow	—	20,109
Unpaid loss and loss adjustment expenses	(14,201)	(21,245)
Unearned premiums	6,218	(5,443)
Reinsurance payable	530	(969)
Deferred revenue	1,203	(3,657)
Other, net	7,557	(2,363)
Net cash used in operating activities	(16,807)	(14,887)
Investing activities:		
Proceeds from sale and maturities of fixed maturities	37,356	21,275
Purchase of fixed maturities	(32,423)	(50,075)
Purchase of equity securities	(750)	—
Net purchases of property and equipment and other intangible assets	(348)	(234)
Net cash provided by (used in) investing activities	3,835	(29,034)
Financing activities:		
Common stock issued	132	350
Proceeds from issuance of notes payable	—	2,250
Net cash provided by financing activities	132	2,600
Net decrease in cash and cash equivalents	(12,840)	(41,321)
Cash and cash equivalents at beginning of period	85,486	140,567
Cash and cash equivalents at end of period	$72,646	$99,246

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2012

NOTE 1 BUSINESS

Kingsway Financial Services Inc. (the "Company" or "Kingsway") was incorporated under the Business Corporations Act (Ontario) on September 19, 1989. Kingsway is a holding company and is engaged, through its subsidiaries, in the property and casualty insurance business.

NOTE 2 BASIS OF PRESENTATION

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements of the Company. In the opinion of management, all adjustments necessary for a fair presentation have been included and are of a normal recurring nature. Interim results are not necessarily indicative of the results that may be expected for the year.

The accompanying unaudited consolidated interim financial statements and footnotes should be read in conjunction with the audited consolidated financial statements and footnotes included within our Annual Report on Form 10-K ("2011 Annual Report") for the year ended December 31, 2011.

The unaudited consolidated interim financial statements include the accounts of the Company and its subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation.

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect application of policies and the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates. Estimates and their underlying assumptions are reviewed on an ongoing basis. Changes in estimates are recorded in the accounting period in which they are determined. The critical accounting estimates and assumptions in the accompanying unaudited consolidated interim financial statements include the provision for unpaid loss and loss adjustment expenses, valuation of fixed maturities and equity investments, valuation of deferred tax assets, valuation of other intangible assets and goodwill recoverability, deferred policy acquisition costs, and fair value assumptions for debt obligations.

The fair values of the Company's investments in fixed maturities and equity investments, LROC preferred units, senior unsecured debentures and subordinated debt are estimated using a fair value hierarchy to categorize the inputs it uses in valuation techniques. The fair value disclosure of the Company's investment in investees is based on quoted market prices. Fair values for other investments approximate their unpaid principal balances. The carrying amounts reported in the consolidated balance sheets approximate fair values for cash, short-term investments and certain other assets and other liabilities because of their short-term nature.

The Company's financial results contained herein are reported in U.S. dollars unless otherwise indicated.

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

There have been no material changes to our significant accounting policies as reported in our 2011 Annual Report, except for the effects of adopting Accounting Standards Update ("ASU") 2010-26, Financial Services-Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts ("ASU 2010-26"). Refer to Note 8, "Deferred Policy Acquisition Costs" for further disclosure.

NOTE 4 RECENTLY ISSUED ACCOUNTING STANDARDS

In October 2010, the Financial Accounting Standards Board ("FASB") issued ASU 2010-26. The amendments in ASU 2010-26 address diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral; they clarify which costs should be deferred and which costs should be expensed when incurred. The amendments in ASU 2010-26 became effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. We adopted this new accounting standard effective January 1, 2012 on a prospective basis. Refer to Note 8, "Deferred Policy Acquisition Costs" for further discussion regarding the impact of this new standard to the Company.

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS ("ASU 2011-04"). Most of the changes in the new standard are clarifications of existing guidance, but it expands the disclosures about fair value measurements. It will require the categorization by level of the fair value hierarchy for items that are not measured at fair value in the statement of financial position but for which the fair value is required to be disclosed. In addition, for fair value measurements categorized as Level 3 within the fair value hierarchy, the valuation processes and sensitivity of the fair value measurements to changes in unobservable inputs shall be disclosed. This standard is effective for interim and annual periods beginning after December 15, 2011, and should be applied prospectively. The Company adopted ASU 2011-04 and the adoption of the new standard did not have a material impact on the consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income ("ASU 2011-05"). ASU 2011-05 requires companies to present the components of net income and comprehensive income in either one or two consecutive financial statements. Companies are no longer permitted to present the components of other comprehensive income as part of the statement of changes in shareholders' equity. Reclassifications from other comprehensive income must be presented in both the consolidated statement of operations and the consolidated statement of other comprehensive income. This standard became effective for interim and annual periods beginning after December 15, 2011, and should be applied retrospectively. In December 2011, the FASB issued ASU 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 ("ASU 2011-12"). The amendments in ASU 2011-12 delay the effective date of certain provisions in ASU No. 2011-05 that relate to reclassification items until such time as the FASB has time to re-deliberate the presentation of those items. All other provisions of ASU No. 2011-05 take effect on the date originally noted in that ASU. The Company adopted ASU 2011-05 and the adoption of the new standard did not have a material impact on the consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment ("ASU 2011-08"). The standard became effective for the first interim or annual period beginning on or after December 15, 2011, with early adoption permitted. The standard amends Accounting Standards Codification Topic 350, Intangibles-Goodwill and Other, and gave companies the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The Company adopted ASU 2011-08 and the adoption did not have an impact on our financial statements. There have been no triggering events that would suggest possible impairment or that it is more-likely-than-not that the fair values of the reporting unit related to our goodwill are less than their carrying amounts. We will utilize the new guidance during our annual impairment testing in December 2012.

NOTE 5 DISCONTINUED OPERATIONS AND DISPOSITIONS

(a) Discontinued Operations

American Service Insurance Company ("American Service"), American Country Insurance Company ("American Country"), Southern United Fire Insurance Company ("Southern United"), and Jevco Insurance Company ("Jevco") were disposed of in 2010 and have been classified as discontinued operations and the results of their operations are reported separately for all periods presented.

Summarized financial information for discontinued operations is shown below.

(in thousands)	Three months ended March 31, 2012	2011
Disposals:		
Loss on disposal before income taxes	$—	$(1,670)
Income tax benefit	—	(377)
Loss on disposal of discontinued operations, net of taxes	$—	$(1,293)

American Country, American Service and Southern United:

During 2010, Southern United was merged into American Service.

On December 31, 2010, the previously announced going-public transaction involving the Company's subsidiaries American Country and American Service by way of a reverse takeover of JJR VI Acquisition Corp. ("J6") was completed. Upon completion of the transaction, J6 was renamed Atlas Financial Holdings Inc. ("Atlas"), and American Country and American Service became wholly-owned subsidiaries of Atlas. Total consideration to the Company as a result of the transaction was approximately $57.0 million, consisting of cash of $7.9 million, preferred shares of Atlas of $18.0 million, and common shares of Atlas of $31.1 million. As part of the transaction, a quota-share agreement was put in place for 90% of up to $10.0 million of adverse development in excess of $1.0 million, based on the provision for unpaid loss and loss adjustment expenses recorded by Atlas at September 30, 2010. The maximum obligation to the Company is $9.0 million.

As a result of the disposal of American Country, American Service and Southern United, the Company recognized an after-tax gain of $0.6 million for the three months ended March 31, 2011.

Jevco:

On January 25, 2010, the Company entered into a definitive purchase agreement with The Westaim Corporation (“Westaim”) to sell all of the issued and outstanding shares of Jevco to Westaim. On March 29, 2010, after receipt of all required regulatory approvals, the sale was completed for a purchase price of C$263.3 million subject to certain future contingent adjustments. The contingent adjustments included up to a C$20.0 million decrease in the purchase price relating to specific future adverse development in Jevco's provision for unpaid loss and loss adjustment expenses at the end of 2012. On March 31, 2011, the Company settled the C$20.0 million contingent adjustments related to the Jevco transactions for C$17.8 million, recording a pre-tax loss of $2.3 million. As a result of the disposal of Jevco, the Company realized an after-tax loss of $1.9 million for the three months ended March 31, 2011.

(b) Dispositions

Hamilton Risk Management Company:

On March 30, 2011, the Company's subsidiary, Kingsway America Inc. ("KAI"), sold all of the issued and outstanding shares of its wholly owned subsidiary Hamilton Risk Management Company (“Hamilton”) and its subsidiaries, including Kingsway Amigo Insurance Company ("Amigo"), to HRM Acquisition Corp., a wholly owned subsidiary of Acadia Acquisition Partners, L.P. (“Acadia”), in exchange for a $10.0 million senior promissory note due March 30, 2014, a $5.0 million junior promissory note due March 30, 2016, and a Class B partnership interest in Acadia, representing a 40% economic interest. A third-party and members of the Hamilton management team hold Class A partnership interests in Acadia representing a 60% economic interest. KAI acts as the general partner of Acadia. As general partner, KAI has control of the policies and financial affairs of Hamilton; therefore, Kingsway will continue to consolidate the financial statements of Hamilton. During the second quarter of 2011, HRM Acquisition Corp. merged into Hamilton. As a result of this transaction, as of March 31, 2012 and December 31, 2011, Hamilton has notes payable balances of $2.2 million maturing in March 2014 with the third-party and $0.2 million maturing in June 2015 with members of the Hamilton management team. The notes bear interest at 2% annually.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2012

NOTE 6 INVESTMENTS

The amortized cost, gross unrealized gains (losses), and estimated fair value of the Company's investments at March 31, 2012 and December 31, 2011 are summarized in the tables shown below:

(in thousands)	March 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. government, government agencies and authorities	$35,142	$1,179	$7	$36,314
Canadian government	3,862	21	68	3,815
States municipalities and political subdivisions	7,181	149	8	7,322
Mortgage-backed	5,634	221	—	5,855
Asset-backed securities and collateralized mortgage obligations	5,980	63	1	6,042
Corporate	45,308	520	144	45,684
Total fixed maturities	$103,107	$2,153	$228	$105,032
Equity investments	2,689	581	6	3,264
Other investments	488	—	—	488
Short-term investments	3,335	—	—	3,335
Total investments	$109,619	$2,734	$234	$112,119

(in thousands)	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. government, government agencies and authorities	$45,316	$1,498	$—	$46,814
Canadian government	3,788	57	55	3,790
States municipalities and political subdivisions	8,195	269	—	8,464
Mortgage-backed	5,958	222	3	6,177
Asset-backed securities and collateralized mortgage obligations	6,414	40	6	6,448
Corporate	21,673	397	112	21,958
Total fixed maturities	$91,344	$2,483	$176	$93,651
Equity investments	2,689	287	16	2,960
Other investments	488	—	—	488
Short-term investments	20,334	—	—	20,334
Total investments	$114,855	$2,770	$192	$117,433

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2012

The table below summarizes the Company's fixed maturities at March 31, 2012, by contractual maturity periods. Actual results may differ as issuers may have the right to call or prepay obligations, with or without penalties, prior to the contractual maturity of these obligations.

(in thousands)	March 31, 2012	
	Amortized Cost	Estimated Fair Value
Due in one year or less	$26,488	$26,590
Due after one year through five years	63,955	65,168
Due after five years through ten years	3,515	3,876
Due after ten years	9,149	9,398
Total	$103,107	$105,032

Gross realized gains and losses on fixed maturities, equity investments and short-term investments for the three months ended March 31, 2012 and March 31, 2011 were as follows:

(in thousands)	Three months ended March 31,	
	2012	2011
Gross gains	273	1
Gross losses	—	—
Total	$273	$1

The following tables highlight the aggregate unrealized loss position, by security type, of fixed maturities, equity investments, and short-term investments in unrealized loss positions as of March 31, 2012 and December 31, 2011. The tables segregate the holdings based on the period of time the investments have been continuously held in unrealized loss positions.

(in thousands)	March 31, 2012					
	Less than 12 Months		Greater than 12 Months		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Fixed maturities:						
U.S. government, government agencies and authorities	$5,187	$7	$—	$—	$5,187	$7
Canadian government	3,614	68	—	—	3,614	68
States municipalities and political subdivisions	2,050	8	—	—	2,050	8
Mortgage-backed	—	—	—	—	—	—
Asset-backed securities and collateralized mortgage obligations	265	1	—	—	265	1
Corporate	21,401	112	1,963	32	23,364	144
Total fixed maturities	$32,517	$196	$1,963	$32	$34,480	$228
Equity investments	198	6	—	—	198	6
Short-term investments	1,000	—	—	—	1,000	—
Total	$33,715	$202	$1,963	$32	$35,678	$234

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2012

(in thousands)					December 31, 2011	
	Less than 12 Months		Greater than 12 Months		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Fixed maturities:						
U.S. government, government agencies and authorities	$7,500	$—	$—	$—	$7,500	$—
Canadian government	1,105	55	—	—	1,105	55
Mortgage-backed	1,026	3	—	—	1,026	3
Asset-backed securities and collateralized mortgage obligations	2,252	6	—	—	2,252	6
Corporate	178	10	1,893	102	2,071	112
Total fixed maturities	$12,061	$74	$1,893	$102	$13,954	$176
Equity investments	224	16	—	—	224	16
Short-term investments	19,998	—	—	—	19,998	—
Total	$32,283	$90	$1,893	$102	$34,176	$192

Fixed maturities, equity investments and short-term investments contain approximately 32 and 22 individual investments that were in unrealized loss positions as of March 31, 2012 and December 31, 2011, respectively.

The establishment of an other-than-temporary impairment on an investment requires a number of judgments and estimates. The Company performs a quarterly analysis of the individual investments to determine if declines in market value are other-than-temporary. The analysis includes some or all of the following procedures as deemed appropriate by the Company:

- identifying all unrealized loss positions that have existed for at least six months;
- identifying other circumstances which management believes may impact the recoverability of the unrealized loss positions;
- obtaining a valuation analysis from third-party investment managers regarding the intrinsic value of these investments based on their knowledge and experience together with market-based valuation techniques;
- reviewing the trading range of certain investments over the preceding calendar period;
- assessing if declines in market value are other-than-temporary for debt instruments based on the investment grade credit ratings from third-party rating agencies;
- assessing if declines in market value are other-than-temporary for any debt instrument with a non-investment grade credit rating based on the continuity of its debt service record;
- determining the necessary provision for declines in market value that are considered other-than-temporary based on the analyses performed; and
- assessing the company's ability and intent to hold these investments at least until the investment impairment is recovered.

The risks and uncertainties inherent in the assessment methodology used to determine declines in market value that are other-than-temporary include, but may not be limited to, the following:

- the opinions of professional investment managers could be incorrect;
- the past trading patterns of individual investments may not reflect future valuation trends;
- the credit ratings assigned by independent credit rating agencies may be incorrect due to unforeseen or unknown facts related to a company's financial situation; and
- the debt service patterns of non-investment grade instruments may not reflect future debt service capabilities and may not reflect a company's unknown underlying financial problems.

As a result of the above analysis performed by the Company to determine declines in market value that are other-than-temporary, there were no write-downs related to fixed maturities and equity investments for other-than-temporary impairments for the quarters ended March 31, 2012 and March 31, 2011.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2012

The Company has reviewed currently available information regarding investments with estimated fair values that are less than their carrying amounts and believes that these unrealized losses are not other-than-temporary and are primarily due to temporary market and sector-related factors rather than to issuer-specific factors. The Company does not intend to sell those investments, and it is not likely that it will be required to sell those investments before recovery of its amortized cost.

The Company does not have any exposure to subprime mortgage-backed investments.

Net investment income for the three months ended March 31, 2012 and March 31, 2011, respectively, is comprised as follows:

(in thousands)	Three months ended March 31, 2012	2011
Investment income		
Interest from fixed maturities	$518	$870
Interest from other	166	120
Dividends	242	227
Gross investment income	$926	$1,217
Investment expenses	(96)	(140)
Net investment income	$830	$1,077

As at March 31, 2012, fixed maturities and short-term investments with an estimated fair value of $15.7 million were on deposit with state and provincial regulatory authorities. Also, from time to time, securities are pledged to third parties to collateralize liabilities incurred under certain reinsurance arrangements. At March 31, 2012, the amount of such pledged securities was $25.9 million.

NOTE 7 INVESTMENT IN INVESTEES

Investment in investees includes investments in the preferred and restricted voting common stock of Atlas as well as the member's capital of each of Oak Street Real Estate Capital GP II, LLC ("Oak Street") and LGIC Holdings, LLC ("LGIC Holdings"). Each investment in investee is accounted for under the equity method. Investment in Atlas is recorded on a three-month lag basis. The carrying value, estimated fair value and approximate voting and equity percentages at March 31, 2012 and December 31, 2011 were as follows:

(in thousands, except for percentages)

	March 31, 2012				December 31, 2011			
	Voting percentage	Equity percentage	Estimated Fair Value	Carrying value	Voting percentage	Equity percentage	Estimated Fair Value	Carrying value
Atlas	30.0 %	74.9 %	$39,072	$46,637	30.0 %	75.1 %	$44,340	$48,592
Oak Street	25.0 %	25.0 %	93	93	25.0 %	25.0 %	97	97
LGIC Holdings	49.0 %	49.0 %	—	—	49.0 %	49.0 %	—	—
Total			$39,165	$46,730			$44,437	$48,689

The fair value of the Company's investment in Atlas at March 31, 2012 in the table above is calculated based on the published closing price of Atlas at December 31, 2011 to be consistent with the three-month lag in reporting its carrying value under the equity method. The estimated fair value of the Company's investment in Atlas based on the published closing price of Atlas at March 31, 2012 is $42.9 million.

The estimated fair value of the Company's investment in Oak Street at March 31, 2012 approximates carrying value due to the investee not being actively traded at March 31, 2012.

During 2011, the Company acquired a 49.0% equity investment in LGIC Holdings. During 2011, the Company performed an impairment review of its investment in LGIC Holdings, which considered the current valuation and operating results of LGIC Holdings. Based upon this review, the Company recorded an impairment charge of $0.2 million during the fourth quarter of 2011.

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Equity in net loss of investees was $2.3 million and zero for the three months ended March 31, 2012 and March 31, 2011, respectively. The Company also recognized an increase to shareholders' equity attributable to common shareholders of $0.3 million as of March 31, 2012 for the Company's pro rata share of its investees' accumulated other comprehensive income.

Summarized financial information for Atlas for the three months ended December 31, 2011 is presented below:

(in thousands)	December 31, 2011
Total revenue	11,216
Net loss	(3,025)

The Company acquired its investment in Oak Street in the fourth quarter of 2011. Summarized financial information for Oak Street for the three months ended March 31, 2012 is presented below:

(in thousands)	March 31, 2012
Total revenue	—
Net loss	(13)

NOTE 8 DEFERRED POLICY ACQUISITION COSTS

Policy acquisition costs consist primarily of commissions, premium taxes, and underwriting and agency expenses incurred related to successful efforts to acquire a new or renewal insurance contract, net of ceding commission income. Policy acquisition costs are deferred and expensed as the related premiums are earned.

As described in Note 4, "Recently Issued Accounting Standards", the Company adopted ASU 2010-26 effective January 1, 2012 on a prospective basis. The new standard affects the timing of recognition of policy acquisition costs. Costs associated with unsuccessful efforts or costs that cannot be tied directly to a successful policy acquisition are expensed as incurred, as opposed to being deferred and amortized as the premium is earned. In periods of growth, the standard will result in an acceleration of expense recognition. In periods of contraction, the opposite will occur. The application of the new standard resulted in capitalized acquisition costs of $8.0 million for the three months ended March 31, 2012 compared with $8.6 million of acquisition costs that would have been capitalized for the three months ended March 31, 2012 if the Company had not adopted the new standard. As a result, the Company recorded $0.6 million more in expense for the three months ended March 31, 2012 than it would have had it not adopted the new standard.

The components of deferred policy acquisition costs and the related amortization expense for the three months ended March 31, 2012 and March 31, 2011, respectively, is comprised as follows:

(in thousands)	Three months ended March 31,	
	2012	2011
Balance at January 1, net	8,116	13,952
Additions	7,969	7,781
Amortization	(7,682)	(8,665)
Balance at March 31, net	8,403	13,068

NOTE 9 GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangible assets are comprised as follows:

(in thousands)	March 31, 2012	December 31, 2011
Goodwill	$510	$510
Intangible assets not subject to amortization		
Insurance licenses	7,803	7,803
Renewal rights	31,318	31,318
Goodwill and intangible assets	$39,631	$39,631

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NOTE 10 UNPAID LOSS AND LOSS ADJUSTMENT EXPENSES

The establishment of the provision for unpaid loss and loss adjustment expenses is based on known facts and interpretation of circumstances and is therefore a complex and dynamic process influenced by a large variety of factors. These factors include the Company's experience with similar cases and historical trends involving loss payment patterns, pending levels of unpaid loss and loss adjustment expenses, product mix or concentration, loss severity and loss frequency patterns.

Other factors include the continually evolving and changing regulatory and legal environment; actuarial studies; professional experience and expertise of the Company's claims departments' personnel and independent adjusters retained to handle individual claims; the quality of the data used for projection purposes; existing claims management practices including claims-handling and settlement practices; the effect of inflationary trends on future loss settlement costs; court decisions; economic conditions; and public attitudes.

Consequently, the process of determining the provision necessarily involves risks that the actual results will deviate, perhaps substantially, from the best estimates made.

The Company's evaluation of the adequacy of unpaid loss and loss adjustment expenses includes a re-estimation of the liability for unpaid loss and loss adjustment expenses relating to each preceding financial year compared to the liability that was previously established. The results of this comparison and the changes in the provision for unpaid loss and loss adjustment expenses, net of amounts recoverable from reinsurers, as of March 31, 2012 and March 31, 2011 were as follows:

(in thousands)	March 31, 2012	March 31, 2011
Balance at beginning of period, net	$119,960	$166,734
Incurred related to:		
Current year	21,533	41,989
Prior years	242	(412)
Paid related to:		
Current year	(7,101)	(12,712)
Prior years	(29,546)	(42,159)
Balance at end of period, net	105,088	153,440
Plus reinsurance recoverable on unpaid loss and loss adjustment expenses	969	23
Balance at end of period, gross	$106,057	$153,463

NOTE 11 DEBT

Debt consists of the following instruments:

(in thousands)	March 31, 2012		December 31, 2011	
	Principal	Fair Value	Principal	Fair Value
6% Senior unsecured debentures due 2012	$1,690	$1,690	$1,657	$1,641
7.5% Senior notes due 2014	26,966	26,292	26,966	26,696
LROC preferred units due 2015	19,706	10,789	19,329	8,845
Subordinated debt	90,500	19,174	90,500	16,432
Total	$138,862	$57,945	$138,452	$53,614

Subordinated indebtedness mentioned above consists of the following trust preferred debt instruments:

Issuer	Principal	Issue date	Interest	Redemption date
Kingsway CT Statutory Trust I	15,000	12/4/2002	annual interest rate equal to LIBOR, plus 4.00% payable quarterly	12/4/2032
Kingsway CT Statutory Trust II	17,500	5/15/2003	annual interest rate equal to LIBOR, plus 4.10% payable quarterly	5/15/2033
Kingsway CT Statutory Trust III	20,000	10/29/2003	annual interest rate equal to LIBOR, plus 3.95% payable quarterly	10/29/2033
Kingsway DE Statutory Trust III	15,000	5/23/2003	annual interest rate equal to LIBOR, plus 4.20% payable quarterly	5/23/2033
Kingsway DE Statutory Trust IV	10,000	9/30/2003	annual interest rate equal to LIBOR, plus 3.85% payable quarterly	9/30/2033
Kingsway DE Statutory Trust VI	13,000	1/8/2004	annual interest rate equal to LIBOR, plus 4.00% payable quarterly	1/8/2034

During the first quarter of 2011, the Company gave notice to its Trust Preferred trustees of its intention to exercise its voluntary right to defer interest payments for up to 20 quarters, pursuant to the contractual terms of its outstanding Trust Preferred indentures, which permit interest deferral. This action does not constitute a default under the Company's Trust Preferred indentures or any of its other debt indentures. At March 31, 2012, deferred interest payable of $4.9 million is included in accrued expenses and other liabilities in the consolidated balance sheets. The cash interest due in 2016 is subject to changes in the London interbank offered interest rate for three-month U.S. dollar deposits ("LIBOR") over the deferral period.

No debt repurchases were made during the quarters ended March 31, 2012 and March 31, 2011.

NOTE 12 INCOME TAXES

Income tax expense (benefit) varies from the amount that would result by applying the applicable United States income tax rate of 34% to loss from continuing operations before income tax expense (benefit) primarily due to a valuation allowance being applied to the Company's operating losses.

The Company maintains a valuation allowance for its gross deferred tax assets at March 31, 2012 and December 31, 2011. The Company's operations have generated substantial operating losses during the last several years. These losses can be available to reduce income taxes that might otherwise be incurred on future taxable income. The Company's operations, however, remain challenged and, as a result, it is uncertain whether the Company will generate the taxable income necessary to utilize these losses or other reversing temporary differences. This uncertainty has caused management to place a full valuation allowance on its March 31, 2012 and December 31, 2011 net deferred tax asset. The Company carries a deferred tax liability of $2.7 million at March 31, 2012 and December 31, 2011, all of which relates to indefinite life intangible assets.

As of March 31, 2012, the Company had no unrecognized tax benefits. The Company analyzed its tax positions in accordance with the provisions of ASC Topic 740, Income Taxes and has determined that there are currently no uncertain tax positions. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense (benefit).

The income taxes recoverable of $7.4 million and $8.1 million at March 31, 2012 and December 31, 2011, respectively, primarily relate to tax receivables of the Company's Canadian operations.

NOTE 13 NET LOSS PER SHARE

Net loss per share is based on the weighted-average number of shares outstanding. Diluted weighted-average shares is calculated by adjusting basic weighted-average shares outstanding by all potentially dilutive stock options. Stock options outstanding of 1,552,500 and 1,591,500 as of March 31, 2012 and December 31, 2011, respectively, were not included in the computation of diluted loss per share because the exercise prices of the options was greater than the average market price of the common stock and thus the inclusion would have been anti-dilutive.

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NOTE 14 ACCUMULATED OTHER COMPREHENSIVE INCOME

The table below details the components of accumulated other comprehensive income, net of tax, for the three months ended March 31, 2012 and March 31, 2011 as relates to shareholders' equity attributable to common shareholders on the consolidated balance sheets. On the other hand, the unaudited consolidated statements of comprehensive loss present the components of accumulated other comprehensive income, net of tax, for the three months ended March 31, 2012 and March 31, 2011 inclusive of the components attributable to noncontrolling interests in consolidated subsidiaries.

	March 31, 2012	March 31, 2011
Balance at January 1	$12,749	$14,407
Unrealized gains (losses) on fixed maturities and equity investments arising during the period	(122)	91
Reclassification adjustment for losses (gains) included in net loss	142	(31)
Foreign currency translation adjustments	1,508	2,498
Equity in other comprehensive income of investee	311	—
Loss on cash flow hedge	—	(200)
Balance at March 31	$14,588	$16,765

NOTE 15 SEGMENTED INFORMATION

The Company is engaged, through its subsidiaries, in the non-standard property and casualty insurance business. The Company conducts its business through the following two reportable segments: Insurance Underwriting and Insurance Services.

Insurance Underwriting Segment

The Company's property and casualty insurance business operations are conducted primarily through the following subsidiaries: Mendota Insurance Company, Mendakota Insurance Company, Universal Casualty Company, Amigo, Kingsway Reinsurance Corporation and Kingsway Reinsurance (Bermuda) Ltd. (collectively, "Insurance Underwriting"). Insurance Underwriting provides non-standard automobile and other types of property and casualty insurance to individuals and commercial automobile insurance to businesses and actively conducts business in 17 states.

Insurance Services Segment

Insurance Services includes the following subsidiaries of the Company: Assigned Risk Solutions Ltd. ("ARS"), Northeast Alliance Insurance Agency, LLC ("NEA") and KAI Advantage Auto, Inc. ("Advantage Auto") (collectively, "Insurance Services").

In 2011, ARS and NEA were organized to run as one business under the ARS name. ARS is a licensed property and casualty agent, full service managing general agent and third-party administrator focused primarily on the assigned risk market. ARS is licensed to administer business in 22 states but generates its revenues primarily by operating in the states of New York and New Jersey.

Advantage Auto is a licensed property and casualty agent. Advantage Auto is licensed as an agency in Illinois and Indiana and produces business in both states.

Results for the Company's reportable segments are based on the Company's internal financial reporting systems and are consistent with those followed in the preparation of the unaudited consolidated interim financial statements. The following tables provide financial data used by management. Segment assets are not allocated for management use and, therefore, are not included in the segment disclosures below.

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Segment revenues for the three months ended March 31, 2012 and 2011 were:

(in thousands)	Three months ended March 31, 2012	2011
Revenues:		
Insurance Underwriting:		
Net premiums earned	$29,267	$45,636
Other income	1,786	2,883
Total Insurance Underwriting	31,053	48,519
Insurance Services:		
Service fee and commission income	9,529	8,972
Total Insurance Services	9,529	8,972
Total segment revenues	40,582	57,491
Net investment income	830	1,077
Net realized gains	273	1
Loss on change in fair value of debt	(4,331)	(2,605)
Other income not allocated to segments	(703)	(972)
Total revenues	$36,651	$54,992

The operating income (loss) of each segment is before income taxes and includes revenues and direct segment costs.
Segment net income (loss) for the three months ended March 31, 2012 and 2011 were:

	Three months ended March 31, 2012	2011
Segment operating income (loss)		
Insurance Underwriting	$(3,239)	$(9,741)
Insurance Services	1,746	1,045
Total segment operating loss	(1,493)	(8,696)
Net investment income	830	1,077
Net realized gains	273	1
Loss on change in fair value of debt	(4,331)	(2,605)
Other income and expenses not allocated to segments, net	(3,623)	(5,311)
Interest expense	(1,849)	(1,903)
Amortization of other intangible assets	—	(18)
Equity in net loss of investees	(2,270)	—
Loss from continuing operations before income tax expense (benefit)	$(12,463)	$(17,455)
Income tax expense (benefit)	59	(408)
Loss from continuing operations	$(12,522)	$(17,047)

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Net premiums earned by line of business for the three months ended March 31, 2012 and 2011 were:

(in thousands)	Three months ended March 31,	
	2012	2011
Insurance Underwriting:		
Private passenger auto liability	$19,407	$31,530
Auto physical damage	7,304	11,728
Total non-standard automobile	26,711	43,258
Commercial auto liability	2,556	2,378
Other	2	1
Total net premiums earned	$29,267	$45,636

NOTE 16 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value amounts represent estimates of the consideration that would currently be agreed upon between knowledgeable, willing parties who are under no compulsion to act. Fair value is best evidenced by quoted bid or ask price, as appropriate, in an active market. Where bid or ask prices are not available, such as in an illiquid or inactive market, the closing price of the most recent transaction of that instrument subject to appropriate adjustments as required is used. Where quoted market prices are not available, the quoted prices of similar financial instruments or valuation models with observable market based inputs are used to estimate the fair value. These valuation models may use multiple observable market inputs, including observable interest rates, foreign exchange rates, index levels, credit spreads, equity prices, counterparty credit quality, corresponding market volatility levels and option volatilities. Minimal management judgment is required for fair values calculated using quoted market prices or observable market inputs for models. Greater subjectivity is required when making valuation adjustments for financial instruments in inactive markets or when using models where observable parameters do not exist. Also, the calculation of estimated fair value is based on market conditions at a specific point in time and may not be reflective of future fair values. For the Company's financial instruments carried at cost or amortized cost, the book value is not adjusted to reflect increases or decreases in fair value due to market fluctuations, including those due to interest rate changes, as it is the Company's intention to hold them until there is a recovery of fair value, which may be to maturity.

The Company classifies its investments in fixed maturities and equity investments as available-for-sale and reports these investments at fair value. The Company's LROC preferred units, senior unsecured debentures and subordinated debt are measured and reported at fair value.

Fair values of equity investments are considered to approximate quoted market values based on the latest bid prices in active markets. Fair values of fixed maturities for which no active market exists are derived from quoted market prices of similar instruments or other third-party evidence.

The fair value of the LROC preferred units is based on quoted market prices, and the fair value of the subordinated debt is estimated using an internal model based on significant market observable inputs. The fair values of senior unsecured debentures, for which no active market exists, are derived from quoted market prices of similar instruments or other third-party evidence.

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The Company employs a fair value hierarchy to categorize the inputs it uses in valuation techniques to measure the fair value. The extent of use of quoted market prices (Level 1), valuation models using observable market information (Level 2) and internal models without observable market information (Level 3) in the valuation of the Company's financial assets and liabilities measured at fair value on a recurring basis as of March 31, 2012 and December 31, 2011 was as follows:

(in thousands)		March 31, 2012		
		Fair Value Measurements at the End of the Reporting Period Using		
	Total	Quoted Prices in Active Markets for Identical Assets(Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring fair value measurements				
Assets:				
Fixed maturities:				
U.S. government, government agencies and authorities	$36,314	$—	$36,314	$—
Canadian government	3,815	—	3,815	—
States municipalities and political subdivisions	7,322	—	7,322	—
Mortgage-backed	5,855	—	5,855	—
Asset-backed securities and collateralized mortgage obligations	6,042	—	6,042	—
Corporate	45,684	—	45,684	—
Total fixed maturities	$105,032	$—	$105,032	$—
Equity securities	3,264	3,264	—	—
Other investments	488	—	488	
Short-term investments	3,335	—	3,335	
Total assets	$112,119	$3,264	$108,855	$—
Liabilities:				
LROC preferred units	$10,789	$10,789	$—	$—
Senior unsecured debentures	27,982	—	27,982	—
Subordinated debt	19,174	—	19,174	—
Total liabilities	$57,945	$10,789	$47,156	$—

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(in thousands)		December 31, 2011		
		Fair Value Measurements at the End of the Reporting Period Using		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring fair value measurements				
Assets:				
Fixed maturities:				
U.S. government, government agencies and authorities	$46,814	$—	$46,814	$—
Canadian government	3,790	—	3,790	—
States municipalities and political subdivisions	8,464	—	8,464	—
Mortgage-backed	6,177	—	6,177	—
Asset-backed securities and collateralized mortgage obligations	6,448	—	6,448	—
Corporate	21,958	—	21,958	—
Total fixed maturities	$93,651	$—	$93,651	$—
Equity securities	2,960	2,960	—	—
Other investments	488	—	488	—
Short-term investments	20,334	—	20,334	—
Total assets	$117,433	$2,960	$114,473	$—
Liabilities:				
LROC preferred units	$8,845	$8,845	$—	$—
Senior unsecured debentures	28,337	—	28,337	—
Subordinated debt	16,432	—	16,432	—
Total liabilities	$53,614	$8,845	$44,769	$—

NOTE 17 RELATED PARTY TRANSACTIONS

Related party transactions, including services provided to or received by the Company's subsidiaries, are carried out in the normal course of operations and are measured in part by the amount of consideration paid or received as established and agreed by the parties. Management believes that consideration paid for such services in each case approximates fair value. Except where disclosed elsewhere in these unaudited consolidated interim financial statements, the following is a summary of related party transactions.
In August 2011, the Company and its subsidiary, 1347 Advisors, entered into a management services agreement with United Insurance Holdings Corp. ("United"), a third-party. This agreement provided that 1347 Advisors supply the services of an interim Chief Financial Officer to United, as well as certain strategy consulting, corporate development, corporate finance and actuarial services. Pursuant to the management services agreement, Hassan Baqar was appointed interim Chief Financial Officer at United. Mr. Baqar is currently a Managing Director of 1347 Advisors as

well as a Vice President of KAI. Mr. Larry G. Swets, Jr., Chief Executive Officer and President of the Company, also served on the Board of Directors of United. In February 2012, Amigo received a letter from the Florida Office of Insurance Regulation ("OIR") which stated that Amigo, the Company and its subsidiaries,

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and United are affiliated entities due to their common managerial control. As a result of the foregoing, among other things, the Company may not transfer any assets to United or any of its affiliates without the prior written approval of the OIR. Subsequently, the Company and United mutually agreed to terminate their management services agreement effective April 2, 2012. Furthermore, Mr. Swets resigned as a member of United's Board of Directors effective April 5, 2012.

NOTE 18 COMMITMENTS AND CONTINGENCIES

In connection with its operations in the ordinary course of business, the Company and its subsidiaries are named as defendants in various actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the loss, or range of loss, if any, that may be incurred in connection with any of the various proceedings at this time, it is possible that individual actions may result in a loss having a material adverse effect on the Company's financial condition or results of operations.

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NOTE 19 SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION

In 2004, KAI issued $125.0 million 7.5% senior notes due in 2014 through a private offering. These notes are redeemable at KAI's option on or after February 1, 2009 and are fully and unconditionally guaranteed by the Company. On July 10, 2007, the Company through its newly formed, wholly-owned subsidiary Kingsway 2007 General Partnership ("K2007GP"), issued C$100.0 million 6% senior unsecured debentures with a maturity date of July 11, 2012, unconditionally guaranteed by the Company ("KFSI") and KAI (each a "Guarantor"). The following tables show condensed consolidating financial information for the Company as of March 31, 2012 and December 31, 2011 and for the periods ended March 31, 2012 and 2011, with a separate column for each Guarantor, the issuer and the other businesses of the Company combined ("Non-Guarantor subsidiaries").

Condensed Consolidating Statement of Operations
For the three months ended March 31, 2012

	KFSI	KAI	K2007 GP	Other subsidiaries	Consolidation adjustments	Total
	(a "Guarantor")	(an "Issuer" and a "Guarantor")	(an "Issuer")	(the "Non-Guarantor subsidiaries")		
Revenue:						
Net premiums earned	$—	$—	$—	$29,267	$—	$29,267
Service fee and commission income	—	—	—	9,529	—	9,529
Net investment income, net realized gains, and other income	671	878	362	275	—	2,186
Loss on change in fair value of debt	—	(2,075)	(49)	(2,207)	—	(4,331)
Management fees	—	—	—	—	—	—
Total revenue	671	(1,197)	313	36,864	—	36,651
Expenses:						
Loss and loss adjustment expenses	—	—	—	21,775	—	21,775
Commissions and premiums taxes	—	—	—	4,419	—	4,419
Other expenses	1,023	1,679	72	16,027	—	18,801
Interest expense	—	3,527	25	(1,703)	—	1,849
Total expenses	1,023	5,206	97	40,518	—	46,844
Loss before equity in net loss of investees and income tax expense (benefit)	(352)	(6,403)	216	(3,654)	—	(10,193)
Equity in net loss of investees	—	(2,266)	—	(4)	—	(2,270)
Loss from continuing operations before income tax expense (benefit)	(352)	(8,669)	216	(3,658)	—	(12,463)
Income tax expense (benefit)	—	—	—	59	—	59
Equity in undistributed net (loss) income of subsidiaries	(10,899)	(3,926)	—	—	14,825	—
Net (loss) income	$(11,251)	$(12,595)	$216	$(3,717)	$14,825	$(12,522)

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	Condensed Consolidating Statement of Operations For the three months ended March 31, 2011					
	KFSI	KAI	K2007 GP	Other subsidiaries	Consolidation adjustments	Total
	(a "Guarantor")	(an "Issuer" and a "Guarantor")	(an "Issuer")	(the "Non-Guarantor subsidiaries")		
Revenue:						
Net premiums earned	$—	$—	$—	$45,636	$—	$45,636
Service fee and commission income	—	—	—	8,972	—	8,972
Net investment income, net realized gains, and other income	(631)	390	86	3,144	—	2,989
Loss on change in fair value of debt	—	(2,753)	(766)	914	—	(2,605)
Management fees	—	182	—	—	(182)	—
Total revenue	(631)	(2,181)	(680)	58,666	(182)	54,992
Expenses:						
Loss and loss adjustment expenses	—	—	—	41,577	—	41,577
Commissions and premiums taxes	—	—	—	7,378	—	7,378
Other expenses	1,140	3,068	73	17,490	(182)	21,589
Interest expense	—	3,608	181	(1,886)	—	1,903
Total expenses	1,140	6,676	254	64,559	(182)	72,447
Loss from continuing operations before income tax expense (benefit)	(1,771)	(8,857)	(934)	(5,893)	—	(17,455)
Income tax (benefit) expense	(483)	—	(57)	132	—	(408)
Equity in undistributed net (loss) income of subsidiaries	(17,698)	(9,535)	—	—	27,233	—
(Loss) income from continuing operations	(18,986)	(18,392)	(877)	(6,025)	27,233	(17,047)
Loss on disposal of discontinued operations, net of taxes	(1,927)	634	—	—	—	(1,293)
Net (loss) income	$(20,913)	$(17,758)	$(877)	$(6,025)	$27,233	$(18,340)

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Condensed Consolidating Balance Sheets
As of March 31, 2012

	KFSI	KAI	K2007GP	Other subsidiaries	Consolidation adjustments	Total
	(a "Guarantor")	(an "Issuer" and a "Guarantor")	(an "Issuer")	(the "Non-Guarantor subsidiaries")		
Assets:						
Investments in subsidiaries	$78,785	$152,500	$—	$ —	$(231,285)	$—
Total investments	—	—	—	164,108	(51,989)	112,119
Investment in investees	—	43,502		94	3,134	46,730
Cash and cash equivalents	15,964	1,397	121	55,164	—	72,646
Goodwill and intangible assets	—	7,803	—	31,828	—	39,631
Other assets	11,956	250,220	22,823	383,070	(571,690)	96,379
Total assets	106,705	455,422	22,944	634,264	(851,830)	367,505
Liabilities and Equity:						
Liabilities:						
Unpaid loss and loss adjustment expenses	$—	$—	$—	$ 106,057	$—	$106,057
Unearned premiums	—	—	—	45,641	—	45,641
LROC preferred units	—	—	—	10,789	—	10,789
Senior unsecured debentures	—	43,354	1,690	—	(17,062)	27,982
Subordinated debt	—	19,174	—	—	—	19,174
Notes payable	—	90,160	—	(87,742)	—	2,418
Other liabilities	963	11,486	23	44,921	(7,691)	49,702
Total liabilities	963	164,174	1,713	119,666	(24,753)	261,763
Equity:						
Common stock	$296,621	$781,289	$17,093	$ 495,396	$(1,293,778)	$296,621
Additional paid-in capital	15,372	—	—	—	—	15,372
Accumulated deficit	(212,214)	(488,815)	6,594	23,509	458,712	(212,214)
Accumulated other comprehensive income (loss)	14,588	(1,226)	(2,456)	(4,307)	7,989	14,588
Shareholders' equity attributable to common shareholders	114,367	291,248	21,231	514,598	(827,077)	114,367
Noncontrolling interests in consolidated subsidiaries	(8,625)	—	—	—	—	(8,625)
Total equity	105,742	291,248	21,231	514,598	(827,077)	105,742
Total liabilities and equity	$106,705	$455,422	$22,944	$ 634,264	$(851,830)	$367,505

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2012

Condensed Consolidating Balance Sheets
As of December 31, 2011

	KFSI	KAI	K2007GP	Other subsidiaries	Consolidation adjustments	Total
	(a "Guarantor")	(an "Issuer" and a "Guarantor")	(an "Issuer")	(the "Non-Guarantor subsidiaries")		
Assets:						
Investments in subsidiaries	$82,564	$171,412	$—	$—	$(253,976)	$—
Total investments	—	—	—	162,695	(45,262)	117,433
Investment in investees	—	45,458		97	3,134	48,689
Cash and cash equivalents	22,389	873	171	62,053	—	85,486
Goodwill and intangible assets	—	7,803	—	31,828	—	39,631
Other assets	12,240	245,037	22,591	1,116,970	(1,313,996)	82,842
Total assets	117,193	470,583	22,762	1,373,643	(1,610,100)	374,081
Liabilities and Equity:						
Liabilities:						
Unpaid loss and loss adjustment expenses	—	—	—	120,258	—	120,258
Unearned premiums	—	—	—	39,423		